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AGENDA ITEM 3c

TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

I. SUBJECT: State Legislative Proposal: Policy and Plan Design Changes

II. PROGRAM: Legislation

III. RECOMMENDATION: Legislative Update

IV. ANALYSIS:

This item updates the Committee on concepts staff is exploring to be responsive to the challenges facing CalPERS. The market crash of 2007 and 2008 significantly cut the market value of public pension funds and forced continuing increases in employer costs to ensure full funding of retirement benefits. Meanwhile, State and local governments have experienced a prolonged period of reduced revenues and budget shortfalls as a result of the Great Recession and its immediate aftermath. As pension fund trustees consider changing asset allocation strategies and their assumed rate of return, the outcome may result in further increases in required contributions from public employers. This is not a situation unique to CalPERS and its participating employers, and as it has developed over the past few years, calls for changes in California and around the nation have increased.

This year, CalPERS hosted forums in Sacramento and Los Angeles and invited retirement experts from academia, the pension industry, as well as employer, labor, and taxpayer organizations, to participate in dialogues regarding what constitutes a reasonable retirement benefit, how costs should be shared by the employer and the employee, and how defined benefit retirement plans can be preserved and strengthened. Recently staff formed a cross-divisional Pension Soundness Working Group to take the next steps of analyzing options to ensure sustainability, maximize responsiveness, encourage accountability and transparency. This working group includes representation from the Actuarial & Employer Services Branch, Member & Benefit Services Branch, and External Affairs.

The most high profile development in California over the past year was pension change for State employees. Included in the State budget were pension formula rollbacks for future employees, and in many instances, increased retirement ages for all newly hired state employees. These actions also included replacing the 12-month final compensation period with 36-month periods for all new State employees not already subject to the 36-month standard, and increasing employee retirement contributions by an additional 2 to 5 percent of payroll for all managers and those bargaining units that approved new agreements.

Mirroring the actions of the State, several CalPERS contracting agency employers negotiated with employee representatives to reduce benefit formulas for new employees, while others imposed such changes through ordinances or at the ballot box. Pension reform measures passed in seven of the eight local agency jurisdictions that had items on their ballots this fall.

Keeping in mind commonly-held objectives to ensure career public servants can retire with an adequate retirement income and enhance retirement security for all public employees, and following the principles outlined in the CalPERS Mission Statement and Strategic Plan and Legislative Policy Standards, the following legislative concepts are being analyzed to improve CalPERS' responsiveness to our members and employers; encourage accountability and transparency; and promote the sustainability of our benefit programs.

Ensure Transparency, Sustain Public Trust and Inspire Confidence of Members and Employers

CalPERS endeavors to establish and maintain an environment of transparency that sustains the public's trust and inspires confidence in our members and employers. We also work to promote a culture of accountability that enhances CalPERS' role as a respected leader in the public pension and benefits industry. The following concepts reaffirm CalPERS' commitment to transparency and encourage the continued accountability and responsibility of CalPERS, its members, and business partners.

1. **Require forfeiture of retirement benefits by high level public officials convicted of felonies.**

Current law requires elected officials elected or reelected to public office on or after January 1, 2006, who are convicted of a felony involving accepting or giving or offering to give any bribe, embezzlement of public funds, extortion or theft of public money, perjury, or conspiracy to commit such crimes arising directly out of his or her official duties as an elected public officer, to forfeit all rights and benefits under and membership in any public retirement system that are attributable to service in the public office held when the felony occurred. Notwithstanding the conviction that otherwise would lead to forfeiture, no forfeiture shall occur if the public agency that employs the elected public officer authorizes the public officer to receive those rights and benefits. In addition, existing law requires judges convicted of a felony offense involving either moral turpitude or that was committed in the course of their duties to forfeit all benefits under either of the Judges Retirement Systems, and provides for the return of his or her accumulated contributions. This law does not extend to appointed high level officials.
Recently, several high-level appointed municipal officials in California have been accused of misappropriating public funds in order to increase their salaries and

benefits. While State law authorizes forfeiture under the circumstances described above for elected officials and judges convicted of a felony, State law does not provide a comparable forfeiture of benefits provision for appointed officials such as city managers, city administrators, county administrative officers, or special district executive directors.

This concept would apply similar forfeiture rules as apply to elected officials to high-level appointed public officials.

Pros:

- Provides equal treatment under the law – public officials and judges are required to forfeit public pension benefits for committing similar crimes.
- Provides a possible deterrent for those who would consider committing these acts while holding office.

Cons:

- It could impact the future benefits of a spouse or dependent.

2. Assess Reasonable Fee or Penalty for Failure to Comply with Employer Reporting Requirements.

Government Code Section 20221 requires employers furnish the Board changes in member status and any other additional information needed for the administration of the system. At times, employers have not provided information when requested or have done so after a considerable length of time, which causes delays in CalPERS determinations and customer service.

The PERL also defines compensation for retirement purposes as the sum of payrate and special compensation. Payrate is a person's normal full time rate of pay or salary and special compensation is pay that an individual is paid in addition to payrate for special skills, knowledge, abilities etc. Each of these two pieces of compensation must meet specific rules to be considered reportable.

An employer is required to report compensation that is to be used in calculating retirement benefits in accordance with the PERL and corresponding regulations. In addition, the employer is required to identify the pay period in which the compensation was earned regardless of when reported or paid. However, some employers have continued to report compensation that does not meet these specific rules, or have done so incorrectly, despite notification from CalPERS.

This concept would allow the Board to assess a reasonable fee on an employer who fails to provide required information timely or report compensation in accordance with the PERL or regulations, including the costs of auditing, adjusting, or correcting inaccurate reporting. Specifically this concept would:

- Authorize the Board to assess a reasonable penalty on employers that fail to provide timely information to CalPERS for administration of the system.

- Authorize the Board to assess a reasonable fee to cover audit and adjustment costs on employers who knowingly fail to report employee compensation correctly or fail to identify the pay period in which compensation was earned.

Pros:
- Achievement of more timely information related to compensation and membership status changes.
- Reduces delays in accurately maintaining member accounts.
- Having fines imposed may discourage employers from knowingly reporting compensation that does not meet statute or regulations.

Cons:
- Added fiscal burden to local governments who are already suffering financially.

3. Require employers to pay the cost of an agency review that exceeds the time estimate provided by the Board.

Existing law authorizes the Board to include a reasonable fee to cover its costs of administering the System when it sets employers' annual retirement contribution rates. The Board also has the authority to assess a reasonable fee when a contracting agency fails to submit reports or forward contributions on a timely basis.

In the past, some public agency reviews have required an excessive amount of time to complete for reasons such as lack of cooperation, malfeasance, poor internal controls or poor recordkeeping on the part of the agency under review. These situations can result in unanticipated administrative costs to CalPERS. Currently, CalPERS only recoups these costs by distributing among all contracting agencies the costs incurred by unreasonable audit times, penalizing responsible employers. This concept would consider making the following changes:

- Require the Board to prepare and deliver to a contracting agency the estimated time required to complete its review of CalPERS-related compliance issues.
- Establish criteria used to estimate review times.
- Require contracting agencies to reimburse CalPERS for review costs that exceed the CalPERS estimate.
- Limit total fees charged to the additional costs actually incurred by CalPERS.

Pros:
- Encourages better employer recordkeeping of documents that are necessary for CalPERS to assess the correctness of benefits, reportable compensation, and membership.
- Requires agencies to bear the costs associated with lack of cooperation or poor recordkeeping and may discourage future lapses.

Cons:

- Any proposed method for determining agency review time estimates and related charges could be seen as imprecise and potentially subjective.
- Added fiscal burden to local governments who are already suffering financially.

Create Additional Employer Flexibility for Benefit Contracting

As the largest public pension system in the nation, CalPERS is committed to providing innovative, sustainable benefits and services, while ensuring our members and beneficiaries receive their promised future pension and health benefits and secondly minimize employer costs and stabilize contributions. The CalPERS mission statement supports the goal of being responsive to its constituents.

During 2010, the State of California approved statutory changes to reduce retirement formulas and increase final compensation calculation periods for its new employees. Through the collective bargaining process, the State of California increased retirement contributions for groups of both current and future State employees. Some local governments outside of CalPERS have also negotiated in recent years for less generous retirement benefits for their new employees in an attempt to lower future pension obligations.

In the current economic climate, where it is increasingly more difficult for local government to match revenues with expenditures, many stakeholders have expressed interest in making similar options available to public agencies that contract with CalPERS for pension benefits. The following concepts were developed at the suggestion of stakeholders and consider the collaborative efforts undertaken by other jurisdictions. They propose innovative solutions that will assist stakeholders in adapting to the changing conditions and fiscal constraints they face.

4. Create greater opportunities for member cost sharing during collective bargaining.

CalPERS member contributions toward retirement benefits vary according to the benefit formula contracted by the applicable employer and fixed in statute. Employers that have negotiated retirement benefit improvements may also contract with CalPERS to require the affected members to pay a share of the contributions that would otherwise be required of the employer for that improvement. This form of cost sharing must be applied equally to all employees of the same classification (e.g. miscellaneous, police, fire).

Recently, several State bargaining units agreed through collective bargaining to increase the employee’s share of pension contributions. Public agencies are negotiating similar arrangements. However, CalPERS does not have the statutory authority to recognize these types of arrangements.

In addition, the existing cost sharing restrictions in the PERL prevent employers that negotiate different tiers of retirement benefits for the same classification of employees (usually based on an employee's date of employment) from negotiating for different cost sharing arrangements for employees based on the retirement formulas they receive.

Therefore, if an employer has miscellaneous members under both a 2 percent @ 55 and 2 percent @ 60 retirement formula, then any cost sharing arrangement would require that all miscellaneous employees pay the same amount even if the cost of their benefits is different.

This concept would consider whether the plan can be amended to:

- Eliminate the restriction that member cost sharing be linked to a benefit improvement, while providing a cap on the maximum amount the employee asked to share.
- Narrow the restriction that member cost sharing must apply to all members of the same classification, to only members of the same classification within the same retirement formula.

Pros:

- Employers and employee organizations could have more flexibility in collective bargaining.
- Employers who adopt cost sharing would enjoy saving in approximately the same amount as the additional member contributions.
- Recognizing cost sharing would allow the additional employee contributions to go into the member's account rather than the employers account.
- If a member fails to vest, the member would get back the additional contributions plus interest.

Cons:

- No overall pension cost savings.
- Shifts cost from the employer to the employee.

5. Provide a local agency contract option for prospective-only benefit improvements.

The State is authorized under statute to negotiate with designated employee representative organizations to agreed upon formulas for retirement and other benefits. Most contracting agencies also engage in collective bargaining to determine salary and benefits. When employers agree to improve age and benefit factors for CalPERS members, the PERL requires that the improvements apply not only to new service (rendered by active members on or after the effective date of the contract), but also to past service rendered by active employers for that employer.

When contracting agencies provide retroactive benefits to active employees, the result is an immediate increase in the existing liabilities of their retirement plan. These retroactive benefits have not been funded by prior employer or employee contributions. Adding a contract option that would allow employers to contract for benefit formula enhancements on a prospective-only basis would eliminate the immediate increase in existing liabilities for past service, and accordingly would provide lower cost alternatives for employers and employees. This concept would provide an option of having improvements to benefit formulas requested by a contracting agency to apply prospectively, only to creditable service performed on or after the effective date of the agreement.

Pros:

- Employers would experience savings to the extent that they chose to improve benefits on a prospective basis, rather than including prior service as well.
- An employer and employee could agree to a benefit improvement without creating unfunded obligations for past service.
- Would provide additional flexibility during collective bargaining.

Cons:

- Would create administrative challenges to develop and administer a more complex system of tracking and calculation.

Next Steps

Staff will continue to evaluate these and other concepts and welcome the Board's feedback and suggestions. Staff is targeting to bring back in February a complete analysis on those concepts and seek action for a Board Sponsored Legislative Package.

The Pension Soundness Working Group staff will also be looking at changes on an ongoing basis that are taking place across the country to other governmental plans. A preliminary review shows that many states have made similar changes as the State of California, such increasing normal retirement ages and lengthening final average compensation periods. States have made other changes such as increasing the number of years to vest, suspending COLA's, and adjusting interest calculations on inactive and terminated member accounts. A few states have instituted a hybrid plan for new hires, and one state provides new hires a choice between a defined contribution plan and a hybrid plan. Attached is list of changes to State public pension plans compiled by National Association of State Retirement Administrators.

V. STRATEGIC PLAN:

This item supports Strategic Goal III to develop, design, and administer benefit programs and business processes that are innovative, effective, efficient, and valued by our members, employers, and stakeholders

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